Supreme Court, U. S.
FILED
APR 4 1980
MICHAEL RODAK, JR., CLERK

No. 79-1266

In the Supreme Court of the United States

OCTOBER TERM, 1979

CHARLES W. STEADMAN, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

WADE H. MCCREE, JR.
Solicitor General
Department of Justice
Washington, D.C. 20530

RALPH C. FERRARA
General Counsel

JACOB H. STILLMAN
Associate General Counsel

ROSALIND C. COHEN
Assistant General Counsel

S. LEE TERRY, JR.
Attorney
Securities and Exchange Commission
Washington, D.C. 20549

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-34) is reported at 603 F. 2d 1126. The opinion of the Securities and Exchange Commission (Supp. App. 1-122) is reported at 12 S.E.C. Docket 1041.

JURISDICTION

The judgment of the court of appeals was entered on October 4, 1979, and a petition for rehearing was denied on November 27, 1979. The petition for a writ of certiorari was filed on February 15, 1980. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether, in an administrative proceeding before the Securities and Exchange Commission, violations of

antifraud provisions of the federal securities laws must be proved by clear and convincing evidence, rather than by a preponderance of the evidence.

STATEMENT

In June 1971, the Securities and Exchange Commission instituted an administrative proceeding against petitioner Steadman and certain of his wholly owned companies, including Steadman Securities Corporation ("SSC"), an investment adviser registered with the Commission, and Republic Securities Corporation ("RSC"), a broker-dealer registered with the Commission. The administrative order initiating the proceeding alleged violations of various provisions of the federal securities laws resulting from petitioner's management (through his wholly owned companies) of several mutual funds registered under the Investment Company Act of 1940, 15 U.S.C. 80a-1 *et seq.*

After an evidentiary hearing, the Commission found that petitioner had violated various antifraud[1] and reporting[2] provisions of the federal securities laws by, *inter alia*, intentionally concealing his practice of obtaining loans for himself and certain of his wholly owned companies from banks in which he caused the mutual funds that he managed ("the Funds") to maintain large cash deposits in non-interest-bearing checking

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[1]Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a); Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5; Section 206(1) and (2) of the Investment Advisers Act of 1940, 15 U.S.C. 80b-6(1) and (2).

[2]Section 17(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78q(a), and Rule 17a-5 thereunder, 17 C.F.R. 240.17a-5; Sections 20(a), 30(a) and 34(b) of the Investment Company Act of 1940, 15 U.S.C. 80a-20(a), 80a-29(a) and 80a-33(b).

accounts (Supp. App. 32-37, 79-81).[3] In making its findings, the Commission utilized the traditional standard of proof applicable in administrative proceedings involving alleged violations of the federal securities laws — the preponderance of the evidence standard (Supp. App. 97-99 n.88). In light of the serious violations that it found, the Commission determined that petitioner should be barred permanently from association with investment advisers or registered investment companies and also should be suspended for one year from association with brokers or dealers in securities (Supp. App. 95-113).

Petitioner sought review of the Commission's decision in the United States Court of Appeals for the Fifth Circuit, contending, *inter alia*, that the Commission should have utilized the clear and convincing evidence standard rather than the preponderance of the evidence standard in evaluating the record. The court of appeals rejected that contention, holding that proof by a

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[3]The Commission also found that (1) petitioner, SSC, and its subsidiaries failed to file timely annual reports for three of the Funds and for petitioner's four broker-dealer firms, in violation of Section 30(a) of the Investment Company Act of 1940, 15 U.S.C. 80a-29(a), and Section 17(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78q(a) (Supp. App. 78-85); (2) RSC, aided and abetted by SSC and petitioner, accepted and retained solicitation fees for tender of securities held by the Funds when SSC was already being compensated for the decision to tender the securities in its capacity as investment adviser to the Funds, in violation of Section 17(e) of the Investment Company Act of 1940, 15 U.S.C. 80a-17(e) (Supp. App. 73-77); (3) SSC failed promptly to remit excess advisory fees received from the Funds, in violation of Section 15(a)(1) of the Investment Company Act of 1940, 15 U.S.C. 80a-15(a)(1) (Supp. App. 67-71); (4) petitioner and SSC failed to disclose its retention of these excess fees, in violation of various antifraud and reporting provisions (Supp. App. 72-73); and (5) petitioner and SSC caused certain of the Funds to buy securities from and sell securities to other Funds, thereby aiding and abetting violations of Section 17(a) of the Investment Company Act of 1940, 15 U.S.C. 80a-17(a) (Supp. App. 85-94).

preponderance of the evidence was sufficient in this context (Pet. App. 26). In so holding, the court of appeals expressly declined to follow the decision of the United States Court of Appeals for the District of Columbia Circuit in *Collins Securities Corp.* v. *SEC*, 562 F. 2d 820, 824 (1977), which required the Commission to employ a clear and convincing evidence standard in administrative proceedings brought against broker-dealers under Section 15(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78*o*(b), which involve allegations of fraud and substantial sanctions (Pet. App. 23-25).

The court below followed the approach of this Court in *Addington* v. *Texas*, 441 U.S. 418, 428-433 (1979), in balancing petitioner's interest and the public interest (Pet. App. 24). The court was of the view that the risk that petitioner might be excluded from the investment advisory business due to an erroneous finding of fact did not outweigh the potential injury to the public from an erroneous finding. Accordingly, the court of appeals held that it was appropriate for both parties here to bear the risk of error equally by use of a preponderance of the evidence standard of proof (Pet. App. 26).[4]

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[4]The court of appeals remanded the case to the Commission so that the Commission could further explain its rationale for the sanction imposed in this case (Pet. App. 27). Despite this remand, we believe that the standard of proof issue is ripe for review by this Court at this time. The Commission's further explanation of its choice of remedy would not aid this Court in resolving the legal issue of the applicable standard of proof. Moreover, clarification of the standard of proof question at this juncture should permit the Commission to dispose finally of all of the disputed questions in this proceeding upon remand and will avoid the need for multiple remands to the Commission in the event that this Court were to disagree with the Fifth Circuit on the applicable standard of proof.

DISCUSSION

The court of appeals correctly determined that proof by clear and convincing evidence is not required in Commission administrative proceedings involving alleged violations of the antifraud provisions of the federal securities laws. Nevertheless, in view of the importance of the burden of proof standard to the administration of the federal securities laws and the conflict among the circuits as to the appropriate standard, the Commission believes that the petition for a writ of certiorari should be granted.

1. The issue raised by petitioner is important. The Commission is charged with enforcing the federal securities laws for the protection of investors, and one of the principal means by which the Commission carries out this mandate is through the commencement of administrative proceedings against securities industry professionals and others to determine whether they have violated the federal securities laws.[5] In such proceedings, the Commission endeavors to protect the general public and investors from violations of the law, and the sanctions that it imposes are remedial in nature.[6] The court below properly recognized (Pet. App. 26) that, if the Commission were required to evaluate the evidence under a "clear and convincing" standard of proof, its ability to enforce the laws governing the securities

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[5]See, *e.g.*, Section 15(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78*o*(b); Section 9(b) of the Investment Company Act of 1940, 15 U.S.C. 80a-9(b); Section 203(e) and (f) of the Investment Advisers Act of 1940, 15 U.S.C. 80b-3(e) and (f).

[6]*Berko* v. *SEC*, 316 F. 2d 137, 143 (2d Cir. 1963); *Blaise D'Antoni & Associates, Inc.* v. *SEC*, 289 F. 2d 276, 277 (5th Cir.), rehearing denied per curiam, 290 F. 2d 688, cert. denied, 368 U.S. 899 (1961); *Associated Securities Corp.* v. *SEC*, 283 F. 2d 773, 775 (10th Cir. 1960); *Pierce* v. *SEC*, 239 F. 2d 160, 163 (9th Cir. 1956); *Wright* v. *SEC*, 112 F. 2d 89, 94 (2d Cir. 1940).

industry would be significantly eroded and investors would be deprived of protections intended by Congress.

The standard of proof question raised in this case is a continually recurring question.[7] The Commission is authorized to bring administrative proceedings charging violations of the antifraud provisions of the federal securities laws under several of the statutes that it administers. Numerous Commission administrative proceedings are brought each year, a large number of which allege violations of antifraud provisions.[8]

2. The decision of the court of appeals in this case directly conflicts with two decisions of the District of Columbia Circuit concerning the applicable standard of proof in an administrative proceeding involving alleged violations of antifraud provisions of the federal securities laws. See *Collins Securities Corp.* v. *SEC*, 562 F. 2d 820 (1977), and *Whitney* v. *SEC*, 604 F. 2d 676 (1979). In

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[7]See, *e.g.*, *In re Sartain*, Securities Exchange Act Release No. 16561, 19 S.E.C. Docket 562 (Feb. 8, 1980); *In re Podesta*, Securities and Exchange Act Release No. 16209, 18 S.E.C. Docket 404 (Sept. 18, 1979), petition for review pending, No. 79-2335 (D.C. Cir.); *In re Nickolaou*, Securities Exchange Act Release No. 16210, 18 S.E.C. Docket 409 (Sept. 18, 1979), petition for review pending, No. 79-2314 (7th Cir.); *In re Decker*, Investment Advisers Act Release No. 641, 15 S.E.C. Docket 1342 (Oct. 16, 1978), petition for review pending, No. 78-2008 (10th Cir.); *In re Schultz*, Securities Exchange Act Release No. 15100, 15 S.E.C. Docket 860 (Aug. 28, 1978), aff'd, [Current] Fed. Sec. L. Rep. (CCH) para. 97,234 (7th Cir. 1980); *In re Lechman*, Securities Exchange Act Release No. 15101, 15 S.E.C. Docket 864 (Aug. 28, 1978), aff'd without opinion, No. 78-1869 (D.C. Cir. Dec. 12, 1979); *In re Investors Research Corp.*, Investment Company Act Release No. 10223, 14 S.E.C. Docket 1020 (May 1, 1978), petition for review pending, Nos. 78-1589 and 11597 (D.C. Cir).

[8]In the past decade (1970-1979), the Commission has instituted a total of 864 administrative proceedings in which the order commencing the proceeding alleged violations of one or more of the antifraud provisions involved in this case.

Whitney, the District of Columbia Circuit reaffirmed and extended the rule of *Collins* (see page 4, *supra*), holding that "any sanction imposed under section 15(b) [of the Securities Exchange Act of 1934] which depends on a finding of fraud must be sustained by clear and convincing evidence." 604 F. 2d at 681. In a footnote to the quoted passage, the court explained that it "intend[s] the word 'fraud' not merely in its common-law sense, but comprehending all violations of § 10(b) and rule 10b-5." *Id.* at 681 n.19.[9] The holdings of the District of Columbia Circuit cannot be reconciled with the decision of the court of appeals in the present case.[10]

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[9]The District of Columbia Circuit has recently extended the *Collins-Whitney* "clear and convincing" evidence standard to encompass broadcast license revocation proceedings conducted by the Federal Communications Commission. The court held that the revocation of a three-year FCC broadcast license for misrepresentations made by the licensee to the FCC is a sufficiently serious sanction to require application of the clear and convincing evidence standard: *Sea Island Broadcasting Corp.* v. *FCC*, No. 76-1735 (D.C. Cir. Jan. 14, 1980), slip op. 6-9.

[10]The *Collins-Whitney* rule is also contrary to decisions rendered prior to the instant case. It conflicts with decisions of the Second Circuit and in principle with decisions of the Fifth and Seventh Circuits. See *Wright* v. *SEC*, 112 F. 2d 89 (2d Cir. 1940); *In re De Mammos*, 43 S.E.C. 333 (1967), aff'd without opinion, No. 31469 (2d Cir. Oct. 13, 1967); cf. *Kent* v. *Hardin*, 425 F. 2d 1346, 1349 (5th Cir. 1970) (preponderance standard applicable to suspension of commodities broker); *G.H. Miller & Co.* v. *United States*, 260 F. 2d 286 (7th Cir.), on rehearing en banc, 260 F. 2d 294 (1958), cert. denied, 359 U.S. 907 (1959) (preponderance standard applicable to revocation of registration as futures commission merchant and floor broker).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

WADE H. MCCREE, JR.
Solicitor General

RALPH C. FERRARA
General Counsel

JACOB H. STILLMAN
Associate General Counsel

ROSALIND C. COHEN
Assistant General Counsel

S. LEE TERRY, JR.
Attorney
Securities and Exchange Commission

APRIL 1980

DOJ-1980-04